

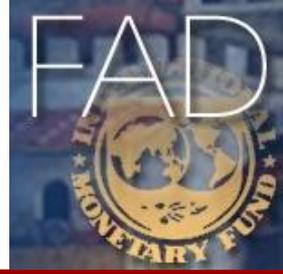
# Fiscal Risk Transparency

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June 6, 2013



# Fiscal Risk Transparency Outline

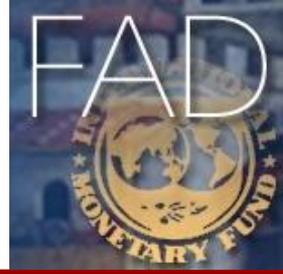
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- Risk Awareness
- Achieving Fiscal Risk Transparency
- Moving to Risk Management

# Risk Awareness

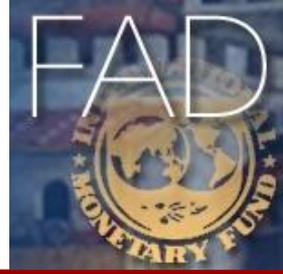
## What are Fiscal Risks?



Deviation in fiscal variables from what was expected at the time of the budget or other forecasts

# Risk Awareness

## Why Worry?



- Big impact

- Gross debt (percent of GDP)

2007	2008	2009	2010	2011
7.8	17.2	32.9	39.7	37.5

- airBaltic (2011): 0.4 percent of GDP

- Adjustment is costly

- Unpredictable budgets, especially within year supplementary budgets, reduce effectiveness of spending
- Growth reduction
- Instability

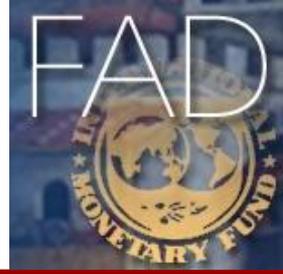
# Risk Awareness

## Types of Fiscal Risks



- **Macroeconomic Risks**
  - Exchange rate, interest rates, terms of trade, growth
  - Natural disasters
- **Explicit contingent liabilities**
  - Guarantees
  - Court cases
  - Financial instruments
- **Implicit contingent liabilities**
  - State-owned enterprises
  - Public-private partnerships
  - Quasi-fiscal activities
  - Banking system

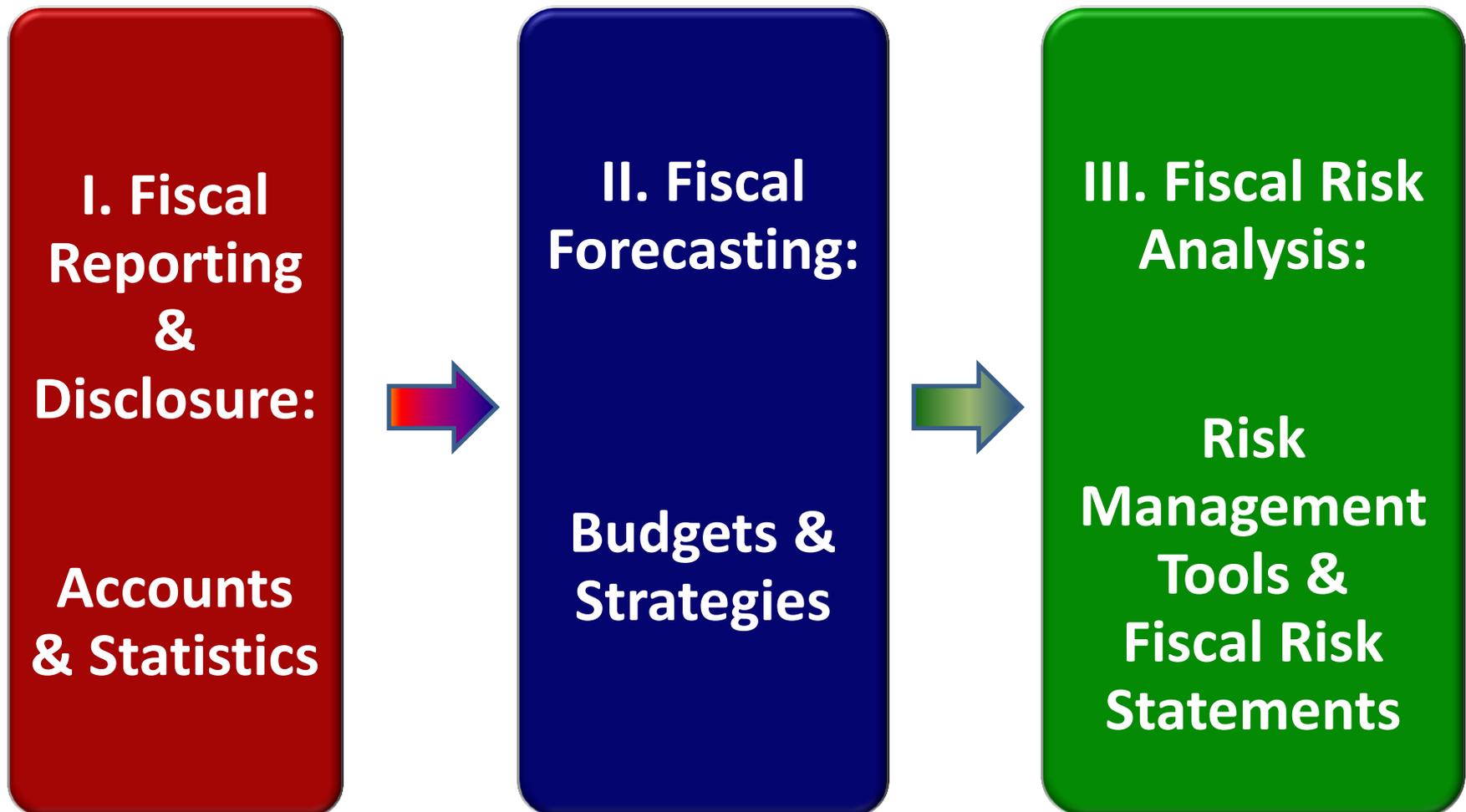
# Risk Awareness Fiscal Discipline Law



- FDL Section 16 (with Section 5)  
Objective: balanced budget over economic cycle
  - Macroeconomic risk indicators:
    - GDP, inflation
  - Fiscal indicators:
    - General government: structural balance, overall balance
    - State budget: revenue, maximum permissible expenditure
  - General Management by Cabinet of Ministers
    - Annual disclosure
    - Probability and impact
    - Measures for prevention and mitigation
    - Cooperation within General Government
- What about?
  - Debt
  - Specific risks

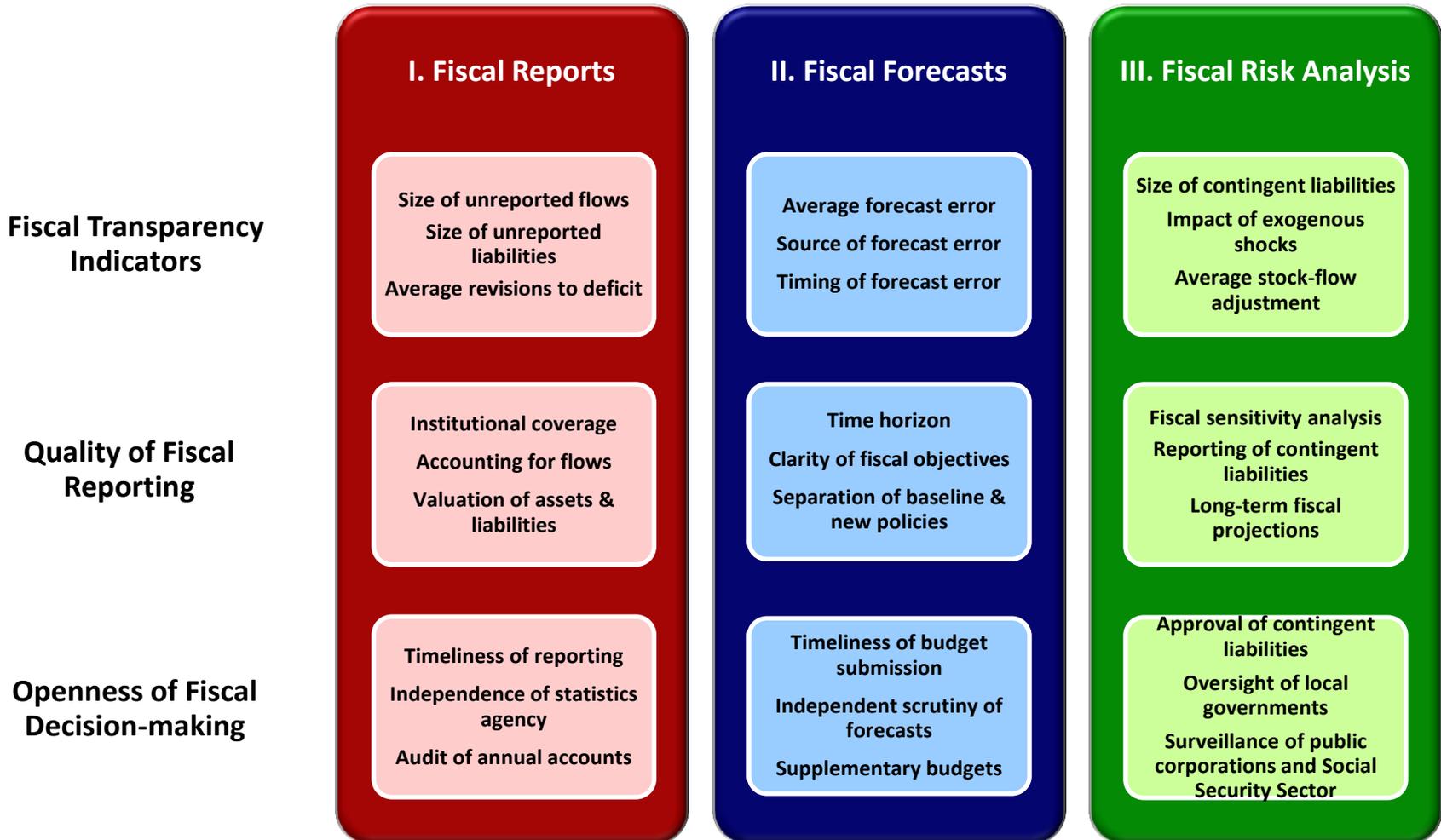
# Achieving Risk Transparency

## Rev. Fiscal Transparency Code: 3 Pillars



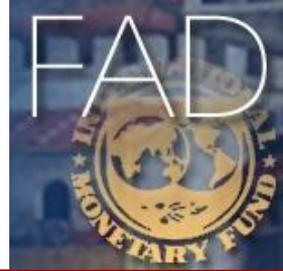
# Achieving Risk Transparency

## Architecture of the Revised Fiscal Transparency Code



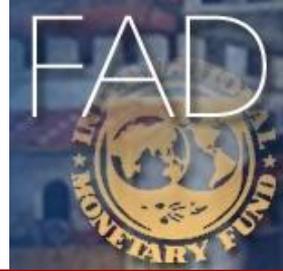
# Achieving Risk Transparency

## Quantifying Risks



- Maximum amount
- Probabilities
  - Expected value, standard deviation, skewness
- Sensitivity analysis
- Scenario analysis, stress tests
- Frequency distributions and Value at Risk
- Timing effects

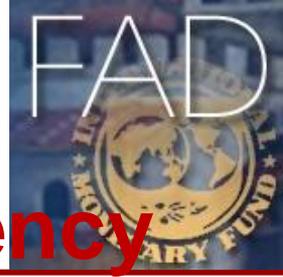
# Achieving Risk Transparency Fiscal Risk Statement



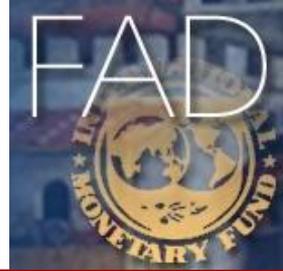
- **Fiscal Discipline Law:**
  - Section 5 (4): Explanations annexed to Framework Draft Law
  - Section 16: Annual Declaration of Fiscal Risks, especially (4) and (5)
- **Nature:** Background document
- **Choice:** Materiality
- **Content to consider:**
  - Macroeconomic: Sensitivities, scenarios, probabilities
  - Guarantees and explicit contingent liabilities
  - Banking sector
  - State-owned enterprises

# Achieving Risk Transparency

## PFM Practices for Effective Transparency



- Assign staff
  - Mandate and freedom to explore
  - Access to data
  - Skills and training
- Consider risk assessments during decision making
  - Timely preparation
  - Well-founded while concise presentation
- 2-way communication between leadership and technical staff
  - What risks?
  - What impact and magnitude?



# Moving to Risk Management

- Prevention
  - Avoid, reduce costs or cap
  - Avoid very large/ low probability outcomes
  - Avoid moral hazard
- Better allocation of risks
  - Transfer or share
  - Diversify or hedge
- Preparedness
  - Have contingency reserves and plans
  - Recognize emerging risk and intervene early

# Fiscal Risk Transparency

